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SUBJECT: GEORGIA: BUDGET OUTLOOK GRIM

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Classified By: CHARGE D'AFFAIRES A.I. KENT LOGSDON FOR REASONS 1.4 (b)
AND (d)

11. (C) Summary: Georgia faces a grim budgetary picture in 2009, according to Deputy Minister of Finance Dimitri Gvindadze. In a meeting with USAID Mission Director and Econoff, Gvindadze inquired about the possibility of additional direct budget support, a long-term currency swap, and possible OPIC assistance in aiding Georgia to issue its own country risk insurance. Gvindadze indicated revenues are down and while projections about future revenue streams are almost impossible to make, all indications are that the Ministry of Finance will have to adjust its 2009 revenue estimates downward. The 2009 budget was cut substantially as compared to the 2008 budget, and Gvindadze is pessimistic that further cuts to the spending side of the budget are politically realistic. In short, Gvindadze foresees Georgia facing a larger budget deficit than expected. End Summary.

Revenues Down - Budget Deficit Looms and Cuts Difficult

12. (C) Gvindadze said tax revenues had been down in January compared to 2008. The drop was somewhat expected due to the significantly changed economic environment, however; receipts were less than the GOG had hoped. Gvindadze said because they are in such uncharted territory (investment fallout from the August invasion and the global credit crunch) it was extremely difficult to project this year's revenue flows with any certainty. Gvindadze said current revenue estimates amount to "wandering in the dark," but noted that all signs look negative. He acknowledged that January receipts are always low, but he was not optimistic that near term receipts would show any improvement. Gvindadze said tax and customs revenues are down and remittances (mainly from Russia) are at about 60 percent of the 2008 level. The World Bank October joint needs assessment predicted a USD 453 million budget deficit which Gvindadze thinks is probably too low given his current view that Georgia will likely not see any positive GDP growth in 2009. Finally, Gvindadze noted that there is little left in the budget which can be cut. Both the Ministry of Internal Affairs and the Ministry of Defense saw significant budget reductions. The political reality is that the GOG cannot afford to cut already modest pension and social payments.

Budget Support - Currency Swap - Country Risk Insurance Requested

13. (C) Gvindadze reiterated the GOG position that direct budget support is the best, most effective type of assistance. The GOG will receive USD 40 million from the World Bank an Asian Development Bank respectively, and USD 2.5 million from the Dutch in direct budget support. The EC is planning on giving the GOG 50.7 million euro (USD 64.7 million) for IDP support (Embassy Note: This agreement is not yet signed. End Note.) and 46 million euro (USD 58.7 million) of debt service relief. Despite the aid, the GOG will still have to borrow to make its budget payments. Gvindadze told Econoff that because of the global credit

crisis, the demand for IMF, World Bank and other multi-lateral financial institution support has grown tremendously. Former central and eastern European countries that were previously considered well past the need for IMF type assistance are back in line, making it more difficult to receive financial assistance.

¶4. (C) Gvindadze told us that Georgia is not facing currency pressures. Nevertheless, Gvindadze is interested in a currency swap arrangement. In the Georgian Government's view, a currency swap could reduce investor anxiety about currency risk as well as provide further confidence in the banking sector which holds many of its debt obligations in dollars. (Embassy note: NBG currency reserves have dropped from USD 1.48 billion on January 1, 2009 to USD 1.27 billion current which indicates the GOG is strongly defending the Lari. In spite of Gvindadze's claims, it appears Georgia is facing substantial currency pressure and will be forced to devalue again if current trends continue. After discussion with post's Treasury advisor, we have counseled the Georgians that it is unlikely that the U.S. would agree to engage in such a currency swap. End Note). Along the same lines, the GOG is exploring the idea of providing political risk insurance to investors. As such, PM Gilauri approached us to inquire what types of assistance OPIC can provide (reftel). In both cases, the requests would serve to bolster investor confidence and from the GOG's perspective, start to bring back the flow of FDI which was so vital to Georgia's recent rapid growth and has slowed to a trickle.

Embassy Comment

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¶5. (C) Gvindadze openly noted the differing public and private faces of the discussion of the Georgian economy. The GOG is putting on an optimistic public face, but privately are expressing their concern about the drop in tax returns and general fiscal health of the Georgian economy. Clearly, Gvindadze and other GOG interlocutors will accentuate the negatives when asking for assistance. Nevertheless, we agree that the GOG is facing a budget deficit with few areas left untouched in which to cut. Additionally, in an economy in need of stimulus, spending cuts are unwise especially against the backdrop of a substantial drop in FDI. As Gvindadze says, any reliable projections for the Georgian economy are difficult, but any GDP growth for 2009 would be a positive development. By all accounts, the Georgian economy and budget will face a very difficult 2009. End Comment.
LOGSDON